Office-Supreme Court, U.S.
FILED
SEP 4 1984
ALEXANDER L. STEVAS
CLERK

(2)

No. 84-159

In the Supreme Court of the United States

OCTOBER TERM, 1984

CHARLES JOHNSON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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Petitioner seeks review of the decision of the court of appeals that he was the true earner of compensation paid during the taxable years 1975, 1976, and 1977, and was, therefore, taxable thereon.

1. Petitioner is a professional basketball player who, during the years in issue, played for the Golden State Warriors (Warriors) under National Basketball Association contracts (Pet. App. A4). On August 16, 1974, petitioner entered into an agreement with Presentaciones Musicales, S.A. (PMSA), by which he conveyed to PMSA the exclusive rights to his services as a professional athlete for six years in exchange for PMSA's promise to pay him $1,500

per month for life (*id.* at A5).[1] PMSA later licensed its rights and obligations under the agreement to EST International Limited (EST), which changed its name to Interlit (*ibid.*).

During the summer of 1974, Robert L. Dunnet, petitioner's attorney, negotiated extensively with the Warriors for a new contract for petitioner's services. The Warriors refused to enter into a "licensing" agreement with PMSA and insisted on contracting with petitioner directly. Accordingly, on August 27, 1974, petitioner and the Warriors signed a contract covering the 1974-1975 and 1975-1976 seasons. Pet. App. A5-A6.

No payments were made to petitioner until June 1975, because Dunnett continued to try, unsuccessfully, to create a contractual relationship between PMSA and the Warriors.[2] On April 25, 1975, petitioner executed an Assignment of Contract Rights assigning all payments under his contract with the Warriors to EST (PMSA's successor in interest). Thereafter, the Warriors made all payments, net of withheld federal and state income taxes, dues, and fines, to EST. Pet. App. A6.

On September 15, 1975, petitioner signed new contracts with the Warriors for the 1975-1976 and 1976-1977 seasons. On August 29, 1977, petitioner signed contracts with the Warriors for the 1977-1978 and 1978-1979 seasons. Neither PMSA nor EST participated in any of the negotiations with regard to these

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[1] The agreement was amended in subsequent years to increase petitioner's monthly payment to $2,000 and to provide for loans to petitioner (Pet. App. A9).

[2] By letter dated October 28, 1974, petitioner had instructed the Warriors not to make any salary payments to him (Pet. App. A6 n.4).

contracts. Petitioner signed new Assignments of Contract Rights with respect to each of the above contracts. Pet. App. A7-A8.

Petitioner reported no wages or salary on his federal income tax returns for 1975, 1976, and 1977, but did report the payments he received from EST as business income. The Commissioner issued statutory notices of deficiency, determining that all amounts paid by the Warriors in 1975, 1976, and 1977 for petitioner's services were income to him. Pet. App. A11-A12.

Petitioner filed a petition for redetermination with the Tax Court. That court sustained the Commissioner's determination, finding an absence of any "indicium recognizing [PMSA's] controlling position" on the part of the Warriors and holding this to preclude acceptance of petitioner's contention that PMSA, rather than he, controlled the earning of the income in controversy. Pet. App. A12-A18.

The court of appeals, relying on *Johnson* v. *United States*, 698 F.2d 372 (9th Cir. 1982),[3] affirmed, hold-

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[3] The Commissioner also assessed a deficiency against petitioner for 1978. Petitioner paid this deficiency and sued in the United States District Court for the Northern District of California for a refund. The district court entered summary judgment for the government in that action and the court of appeals affirmed (*Johnson* v. *United States*, 698 F.2d 372 (1982) (Pet. App. A19-A22)). The court of appeals held that petitioner was taxable on the entire amount paid by the teams (the Warriors and the Washington Bullets) to Interlit (PMSA's and EST's successor in interest). The result was based on the fact that petitioner, not PMSA or Interlit, controlled the earning of the income in question since, as a matter of law, the contractual relationship among the parties simply did not amount to a licensing or loan-out arrangement between PMSA and the teams. Taxpayer did not file a petition for a writ of certiorari in that case. Pet. App. A3, A19-A21.

ing that petitioner controlled the earning of the income in controversy because he, and not PMSA, had contracted with the Warriors (Pet. App. A2).

2. It is a basic principle of federal income taxation that income must be taxed to the one who controls its earning. *Lucas* v. *Earl*, 281 U.S. 111 (1930); *Commissioner* v. *Culbertson*, 337 U.S. 733 (1949); *United States* v. *Basye*, 410 U.S. 441 (1973). In *Lucas* v. *Earl*, *supra*, the "seminal precedent" in this area (*Basye*, 410 U.S. at 450), the taxpayer entered into a contract with his wife providing that any property, including income from future personal services, was to be owned jointly. The husband thereafter reported only half of the salary and fees he earned as an attorney. This Court held that the husband was responsible for the entire amount of earned income, stating that salaries must be taxed "to those who earned them" and that "the tax could not be escaped by anticipatory arrangements and contracts however skilfully devised to prevent the salary when paid from vesting even for a second in the man who earned it" (281 U.S. at 114-115). See also *Harrison* v. *Schaffner*, 312 U.S. 579 (1941). Accordingly, where the assignor/wage-earner retains control over the earning of compensation, any attempted shift in the incidence of taxation must be disregarded and the payments must be taxed to the wage-earner: "the fruits" cannot be "attributed to a different tree from that on which they grew" (281 U.S. at 115).

Of course, the incidence of taxation on income derived from personal services does not depend solely on a mechanical determination of who performed the services for which payment was made. For example, an employee whose services are controlled by the em-

ployer is taxable on his salary from the employer, not on the payments made from customers to the employer for the services. Thus, as the courts below recognized (Pet. App. A2, A15, A21), it is necessary to determine whether the individual taxpayer who performs the services is subject to the control of the employing entity in some meaningful sense, and whether the particular services which generate the compensation are performed pursuant to contract or control of the putative employer, as opposed to the individual taxpayer. *Vnuk* v. *Commissioner*, 621 F.2d 1318, 1320-1321 & n.5 (8th Cir. 1980). If, as in *Lucas* v. *Earl*, *supra*, the services are controlled and performed pursuant to a contract made by the individual taxpayer (even though the proceeds are assigned to another entity), the compensation constitutes income to the individual taxpayer.

In the instant case, the Tax Court, affirmed by the court of appeals, concluded that petitioner, and not PMSA or EST, earned and controlled the income at issue. That factual conclusion does not warrant review by this Court, and in any event is plainly correct. The employment contracts were executed solely between petitioner in his individual capacity and the Warriors; PMSA and its successors were in no way obligated to provide any services. The Warriors in fact refused to "license" petitioner from a third party and insisted on employing petitioner directly and personally.[4] Payments were made by the War-

[4] It is therefore somewhat misleading for petitioner to assert in his "Questions Presented For Review" (Pet. i) and subsequently in his petition (Pet. 13) that PMSA and its successors "licensed" petitioner's services to the Warriors. They did no such thing. Petitioner, in his individual capacity, signed contracts with the Warriors, and assigned the proceeds from

riors to EST only after petitioner assigned them to EST. Petitioner's execution of an assignment of contract rights under his Warriors contract itself demonstrates that petitioner regarded these funds as under his control to assign. Accordingly, this case presents no less obvious an anticipatory assignment of income than did *Lucas* v. *Earl*, *supra*.

3. Petitioner attempts to sidestep the anticipatory assignment of income principle by means of two purported distinctions.

a. First, petitioner contends (Pet. 6-11) that the anticipatory assignment of income principle applies only when the taxpayer has a "vested" and "unrestricted" claim to the income at the time he makes the assignment. This is a startling proposition when applied to personal service income, for it would effectively enable any individual to make anticipatory assignments of income, and be freed from tax thereon, merely because (as is usually the case) there is a possibility that he may not find work or may be discharged. For refutation of this proposition, we need look no further than *Lucas* v. *Earl*, *supra*. There, the assignment was of income to be derived from fees for future legal services; plainly, a lawyer has no "vested" or "unrestricted" claim to fees for services he has not yet performed, on behalf of clients he has not yet obtained.

None of the cases on which petitioner relies involved future payments for personal services yet to be performed. *Cold Metal Process Co.* v. *Commissioner*, 247 F.2d 864 (6th Cir. 1957), for example, involved a transfer of income producing property.

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those contracts to PMSA and its successors. There was no contractual or licensing relation whatsoever between the Warriors and PMSA, EST, or Interlit.

And in *Estate of Cole* v. *Commissioner*, 42 T.C.M. (P-H) ¶ 73,074 (1973), the court was careful to distinguish between the "assignment of income which will be earned by the future personal efforts of a taxpayer," such as is involved in the instant case, and the assignment of a contract right, as was involved there.[5]

Petitioner's reliance on *Harrison* v. *Schaffner*, *supra*, is similarly misplaced. *Harrison* involved a taxpayer's assignment of a portion of trust income to her children and son-in-law. Whether the trust income was a "vested" or "unrestricted" right was not a factor in the decision.[6]

b. Second, petitioner contends (Pet. 11-13) that the courts below erred in relying on the fact that the personal service contracts entered into by the Warriors were with petitioner as an individual rather than with PMSA or its successors. This argument is without merit. The issue here is whether petitioner's earnings were controlled by him or by the assignee corporations. The facts indisputably show that all contracts were signed by petitioner in his *individual* capacity. *No* contractual or licensing relation existed between PMSA (or its successors) and the Warriors at any time; indeed, the Warriors

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[5] *Wood Harmon Corp.* v. *United States*, 311 F.2d 918 (2d Cir. 1963), and *Commissioner* v. *Oates*, 207 F.2d 711 (7th Cir. 1953), are distinguishable on similar grounds.

[6] Nor does petitioner glean support from *Teschner* v. *Commissioner*, 38 T.C. 1003 (1962). In light of this Court's decision in *United States* v. *Basye*, *supra* (distinguishing between consensual deflections of income and deflections imposed by law), *Teschner* can stand for no more than the proposition that where a factor independent of the taxpayer irrevocably prevents his ever receiving the income in issue, anticipatory assignment of income principles may not apply.

steadfastly refused to enter such a relation. PMSA and its successors were mere assignees of income generated as a result of petitioner's own contracts. Under settled principles of law (see pages 4-5, *supra*), this is dispositive.

Petitioner's reliance (Pet. 12) on *Foglesong* v. *Commissioner*, 621 F.2d 865 (7th Cir. 1980), is misplaced. In *Foglesong*, "the Corporation and not the taxpayer [was] the party to the contracts under which services [were] performed" (*id.* at 868). Here, the compensation paid by the Warriors was paid pursuant to personal service contracts between petitioner and the Warriors—not between PMSA (or its successors) and the Warriors.

Petitioner also relies (Pet. 12-13) on *R. & L., Inc.* v. *Commissioner*, 84 F.2d 721 (5th Cir. 1936). There, however, the issue before the court was whether the accumulated and undistributed income of a corporation was subject to surcharge. The court's comments on the proper treatment of commissions earned in part by an individual and assigned to the corporation were dicta. Even so, the court observed that "in strictness," the individual should have reported the commissions as income to himself (84 F.2d at 722 (citing *Lucas* v. *Earl*, *supra*)). To the extent that *R. & L., Inc.* pertains to the questions here, it is therefore consistent with the decision below.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

SEPTEMBER 1984

☆ U. S. GOVERNMENT PRINTING OFFICE: 1984 421923 10034